THE PRIVATE EQUITY REVIEW

SEVENTH EDITION

Editor
Stephen L Ritchie

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Editor
Stephen L Ritchie

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PREFACE

The seventh edition of *The Private Equity Review* follows a turbulent and at times nerve-wracking 2017. It was also a year in which private equity demonstrated its strength as an asset class in spite – perhaps because – of that turbulence. Deal activity and fundraising were strong in almost every major market despite fierce competition from public strategic buyers and strong returns in other asset classes, demonstrating private equity's ability to adapt quickly to changing conditions to find profitable investment opportunities. As a result, we expect private equity will continue to play an important role in global financial markets, not only in North America and Western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. In addition, we expect the trend of incumbent private equity firms and new players expanding into new and less-established geographical markets to continue, although recent protectionist trends remain a risk factor.

While no one can predict how 2018 will unfold, one can confidently say that private equity will continue to play an important role in the global economy, and will likely seek to expand its reach and influence. It remains to be seen how local markets and policymakers respond.

Private equity professionals need – now more than ever – guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 27 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this seventh edition of *The Private Equity Review* possible. Each of them is a leader in his or her respective market, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
March 2018

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Part II

Investing

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Chapter 2

AUSTRIA

Florian Cvak and Clemens Philipp Schindler[1]

I OVERVIEW

i Deal activity

Investments

While private equity activity remained robust throughout the year, there were only a handful of larger buyouts completed, of which by far the most prominent deal was the acquisition of Austria-based Schweighofer Fiber by TowerBrook Capital Partners with a reported deal value of over €500 million, followed by the acquisition of CCC Holding GmbH by Ardian from Silverfleet Capital Partners and the acquisition of Vienna-based software house Tricentis by Insight Ventures from Kenneth Partners with a reported deal value of €154 million. Private equity (PE) investments in the mid-market sector (comprising deals with values of between €10 million and €100 million) dropped compared with previous years, although the decrease was less pronounced than at the top end. Examples of mid-market deals include the control investment in Austria-based inet-logistics GmbH by Castik Capital S.a.r.l., the acquisition of a majority stake in VSE-listed Wiener Privatbank by Arca Capital, the acquisition of Leibnitz-based online car trading platform gebrauchtwagen.at by private equity-backed Scout 24 group and the acquisition of a majority stake in Austria-based ABC Marketing GmbH by Swiss Investnet AG. In the growth capital segment, the most notable transactions were the investments by Germany-based Hannover Finanz in Sportnahrung Mitteregger and Trumpf Venture in Vienna-based tech company Xarion Laser Acoustics. Interest in property funds remained stable. Closed transactions included Corestate Capital's forward purchase of the third Vienna Triiiple tower and Accelerate Property's acquisition of a portfolio of specialist DIY retail centres.

Exits

PE exits outnumbered PE investments in 2017. The vast majority of those exits were to strategic investors. However, the two biggest exits (i.e., the sale of CCC Holding GmbH and the sale of Tricentis (already reported on above)) were to PE. Examples of exits to strategic investors include the sale of POOL4TOOL AG by aws-mittelstandsfond to US Jaggaer, the sale of mySugr GmbH by Roche Venture Fund, Austria Wirtschaftsservice, XLHEALTH AG and iSeed Ventures to Roche Holding AG, the sale of M&R Automation GmbH by Quadriga Capital to PIA Automation Holding GmbH, the sale of mechatonic Systemtechnik GmbH

1 Florian Cvak and Clemens Philipp Schindler are partners at Schindler Attorneys.

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by FIDURA Private Equity and Danube Equity to Accuron Technologies Limited, the sale of Prescreen GmbH by Kizoo Technology Ventures to XING AG and the sale of nxtControl GmbH by TecNet Equity to Schneider Electric SA.

Sectors

At the top end, there was no particular trend as deals were spread across different sectors. In the mid-market sector, on the other hand, technology and industrial products and services accounted for most of the deal flow and that trend is expected to continue. Real estate overall remained very hot, though with PE played a lesser role.

ii Operation of the market

In buyout transactions, a private equity firm often involves future management in the due diligence process and the financial modelling. Typically, management is offered the opportunity (and is sometimes even required) to acquire an interest in the target to ensure their commitment. Senior management is sometimes also given the opportunity to invest in the same instruments ('institutional strip') acquired by the private equity firm to ensure that their interests are fully aligned. In the latter case, structuring options are by definition limited. Where management is asked (or given the opportunity) to participate on a target level, share options (in the case of stock corporations), restricted shares (for a description of the typical restrictions, see below), profit participation rights (a contractual arrangement that can be structured as equity or debt and, by contrast to shares, never confers voting rights), virtual shares (that is, a contractual arrangement giving the member a stock-like return) and phantom stock (that is, a contractual arrangement giving the member a bonus depending on operational performance) are the most common structures.

The detailed structuring of incentive packages is usually driven by the tax treatment of the benefits in the jurisdictions of residence. For example, management will have a strong interest in ensuring that any gains in relation to interests acquired are taxed as capital gains (and not as employment income). In that context, it is important that economic ownership of the incentive interest passes at the time of the grant (which in Austria depends on the management members' entitlement to dividends (if any), voting rights and transfer restrictions). If economic ownership does not pass, the entire exit proceeds may be taxable as employment income. Management will typically also have an interest in limiting taxation at the time of the grant. Where economic ownership of the benefit concerned passes for arm's-length consideration (usually management is asked to invest up to one year's salary), there is no taxation of the grant (for Austrian tax residents). If there is no arm's-length consideration, the grant is taxed as employment income. It should be noted that where the investor provides financing to the management, tax authorities may be more inclined to question whether economic ownership has passed for arm's-length consideration. Since the tax treatment of incentive programmes is often somewhat unclear, it is advisable to seek a tax ruling on the related tax issues before deciding on a particular incentive structure.

Where actual shares are held by management, they are usually pooled (e.g., through a partnership) so that the investor technically only has one co-investor, and restricted. Such restrictions typically include a drag-along right of the private equity firm upon an exit and compulsory transfer provisions if the employment with the target group terminates. The consideration due in the case of a compulsory transfer will typically depend on the reason for termination ('good' and 'bad' leaver provisions), although structuring has become less aggressive in that regard given recent developments in employment law.

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Auction processes are relatively common on the Austrian market. A standard auction process will typically be organised by an investment bank (or M&A adviser). As a first step, the investment bank will propose a shortlist of potential bidders and discuss that shortlist with its client. The investment bank will then invite the selected bidders to submit an indicative bid on the basis of an information package (including limited commercial, financial and basic legal information about the target company). Following evaluation of the indicative bids, the investment bank will invite the most promising bidders to conduct Phase I due diligence, for a period of about two to six weeks, and to submit a binding bid (usually together with a markup to a sale and purchase agreement circulated in the middle of the Phase I due diligence). Following evaluation of the binding bids, the seller will engage in negotiations with two to three bidders, which are then granted access to the Phase II due diligence material and red files (if any). The time required for the entire process varies significantly depending on the appetite for the target and the number of bidders involved. It can range from as little as two to three months up to six months or more.

II LEGAL FRAMEWORK

i Acquisition of control and minority interests

A typical acquisition structure for an Austrian private equity transaction involves a set of holding companies (holdcos) incorporated in Luxembourg, the Netherlands or another tax-favourable jurisdiction, and an Austrian acquisition vehicle (bidco) that enters into the purchase agreement and ultimately acquires the shares.[2] The funds will typically try to maximise leverage on the transaction. Where junior debt (e.g., mezzanine) is used, senior lenders will often require junior lenders to lend to a level higher in the structure to achieve not only contractual subordination (which is achieved by entering into an intercreditor agreement) but also structural subordination. The gap between bank debt and the agreed purchase price is then financed by the fund through a combination of equity and institutional debt. The amount of institutional debt that can be deployed is determined by thin-cap rules. While the law does not provide any guidance in this respect, debt-to-equity ratios of 3:1 to 4:1 are generally accepted by Austrian tax authorities.[3]

On or shortly after completion of the share purchase, the target company is usually asked to accede to the financing documents on an exclusive lender basis (to avoid structural subordination of the financing banks to existing lenders of the target company), and to grant guarantees and security interests securing the acquisition debt as well as refinanced target company debt (if any). To the extent such guarantees and security interests secure repayment of the acquisition debt, they are of little commercial value, as they are only valid to the extent:

a that the risk of default of the bidco and the risk of default of the target company (in cases where the security interest is enforced or the guarantee called) are acceptable, and that the granting of the security interest or guarantee will not put the target company

2 For acquisitions made until 28 February 2014, Austrian tax law provided for goodwill amortisation also on share deals involving an Austrian operational target (based on case law, this was extended to EU-resident targets). As this regime is no longer available, foreign bidcos are increasingly employed.

3 Historically, the equity was channelled down to Austria by way of indirect grandparent capital contributions to avoid capital tax (which would have been triggered in the case of a direct parent capital contribution). Capital tax on direct capital contributions was, however, abolished, effective as of 1 January 2016.

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at risk considering the risk of default of the bidco and the likelihood of recovery from the bidco based on the target company's recourse claims against the bidco, where the security interest is enforced or the guarantee is called; and

b the target company receives adequate consideration, which can either be a fee (in which case it should include a margin on top of the fee that would be charged by a bank in a comparable transaction) or an equivalent corporate benefit (e.g., access to financing that would otherwise not be available).

To preserve the validity of guarantees and security interests at least in part and avoid management (and supervisory) board liability, 'limitation language' is typically included in the financing documents that limits the obligations of Austrian obligors to an amount and terms that are compliant with Austrian capital maintenance rules.

At the same time, the private equity fund will seek to implement a tax offset structure, which is aimed at offsetting interest expense at the bidco level with profit generated at the target company level. In principle, there are two methods to achieve this. The first method is to establish a tax group between the bidco and the target company. In such tax group, the fiscal result of the bidco and the target company is consolidated at bidco level. If the aggregated fiscal result of the bidco and the target company is negative, the loss can be carried forward by the bidco to future periods. The formation of such tax group requires a tax allocation agreement and an application to the competent tax office. The required minimum period of a tax group is fulfilled when three full fiscal years have expired. If the tax group is collapsed prior to the lapse of the three-year period, the group members are retroactively taxed on a stand-alone basis. A second method, which is sometimes discussed but rarely ever implemented because of the significant implementation risk it involves, is an upstream merger of the target company into the bidco. Based on past decisions of the Austrian Supreme Court, it is pretty clear that where the bidco carries the acquisition debt for the purchase of the shares of the target company, a downstream merger of the bidco into the target company will not be registered. In certain exceptional cases, an upstream merger of the target company into the bidco may, however, be feasible. The result of such upstream merger would be that the shares in the target company pass to the bidco parent, interest expense on the acquisition debt can be offset against profit, and guarantees and security interests granted by the merged entity (holding the cash-generating assets) are not subject to the limitations under the Austrian capital maintenance rules (see above) and thus will be of greater commercial value to the financing banks. In particular, the last point is often of great interest to the financing banks, which is why this route is sometimes explored when a particular case supports the necessary arguments.

In a buyout transaction, the key legal documents include the acquisition documents: that is, one or more share purchase agreements with the seller and the financing documents (including agreements governing equity contributions and institutional debt coming from the fund, a senior (and mezzanine) facility agreement governing the debt financing coming from the financing banks, security documents and an intercreditor agreement governing priority among the various layers of debt). In addition, where the fund does not acquire all of the outstanding share capital, governance documents are required, including a shareholders' agreement, amended articles of association, and by-laws for the management board and supervisory board (if any). The main areas of concern in the governance documents are the fund's right to appoint sponsor representatives to the supervisory board (or an observer to the supervisory board, or both), sponsor representative liability (see subsection ii, *infra*), a list

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of matters requiring the consent of the fund or the sponsor representative (which should be tailored such that there is no undue influence on the day-to-day business of the management board), anti-dilution provisions, a liquidation preference for the fund, and information and exit rights for the fund.

In most cases, the fund will also insist that at least senior management enters into a management equity incentive arrangement (see Section I, *supra*), and that the management and all key personnel enter into service agreements acceptable to the fund.

ii Fiduciary duties and liabilities

Duties owed by a shareholder

Austrian courts have consistently held that shareholders owe a duty of loyalty to the company and to other shareholders, requiring shareholders to consider the interests of the company and the interests of other shareholders in good faith and in line with *bonos mores*. As a general matter, the scope of the duty of loyalty is more pronounced for closely held companies than for widely held companies, and differs from shareholder to shareholder depending on the ability of the relevant shareholder to make a difference. A majority shareholder may, for instance, be exposed to liability for a failure to appear and vote on a matter under certain circumstances, whereas a minority shareholder will not because his or her appearance (or vote) is of no relevance to the outcome anyway. The duty of loyalty may require a shareholder to appear and approve a proposal of the management board where the implementation of the proposal is necessary for the survival of the company (e.g., a capital increase, a capital reduction or an asset sale in a restructuring). The duty of loyalty does not, however, require a shareholder to provide further financing to a company in financial distress.

A private equity fund shareholder must also consider his or her duty of loyalty at the time of exit. As a general matter, an exiting shareholder must account for the legitimate interests of the company and its shareholders when exiting his or her investment and prevent unnecessary harm (e.g., by excluding unpromising bidders, restricting competitors' access to information and ensuring confidentiality). Accordingly, it is important that a professional process is put in place that complies with these requirements.

The private equity fund should also be aware that, in considering the duty of loyalty, Austrian courts have discussed concepts similar to the 'corporate opportunities doctrine', which, in essence, provides that whenever an opportunity is within the scope of activity of the company, a shareholder is prohibited from exploiting such opportunity for his or her own advantage.

A violation of duties of loyalty may result in claims for damages, cease and desist orders or a challenge of the shareholder vote violating such duties.

Duties owed by members of the management and supervisory boards

As a general matter, all members of the management and the supervisory board (if any) of an Austrian company, including any sponsor representatives, owe to the company (not the shareholders or any other constituents) the following duties:

a a duty of care, requiring members to exercise the level of care of a proper and diligent person in similar circumstances (which includes an obligation to be reasonably informed and articulate any concerns they may have);

b a duty of loyalty, requiring members to act in the best interest of the company and its shareholders and not in their own interest;

c a duty of confidentiality; and

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d in the case of members of the management, a duty not to compete. Supervisory board members are not explicitly prohibited from competing with the company, but any competition will always be subject to scrutiny under the duty of loyalty.

Where a member of the management or the supervisory board is at fault, he or she is jointly and severally liable for any damages incurred by the company with all the other members at fault, unless the shareholders' assembly has approved the measure resulting in the damage. A stock corporation may waive or settle its damage claims with an affirmative shareholder vote of 80 per cent after five years, or even before that with an affirmative vote of all shareholders. A limited liability company may waive or settle damage claims at any time, provided such waiver or settlement does not affect recovery against it by its creditors. A company may also take out directors and officers liability insurance for the members of the management board, in which case the associated expenses are treated as part of the remuneration of the relevant members. A private equity fund should be aware that creditors of a joint-stock company (or, where insolvency proceedings have been opened, the administrator in such proceedings) can bring damage claims on behalf of the company against a member of the management or supervisory board to the extent they cannot recover damages from the company in the following circumstances:

a where such claim is based on provisions protecting the proper pay-in of share capital (including liability for unpaid capital contributions and liability for an unpermitted return of capital) or because of unpermitted payments made during insolvency (also in cases of slight negligence); and

b in other cases, only where the relevant member was grossly negligent.

A waiver by the company or shareholder approval of the relevant measure does not relieve from liability towards creditors (or the administrator).

Other sources of potential liability for the private equity fund involve:

a piercing the corporate veil, which is possible in the following circumstances:
  - factual management by a shareholder, or the exercise of control over the management board by a shareholder (where a shareholder, while not formally appointed, factually manages the company or substantially controls the management board);
  - undercapitalisation (only where there is an obvious imbalance between the risks of the business and the equity that is likely to result in a default of the company damaging creditors);
  - intermingling of assets (where, based on accounting records, the assets of the company cannot be separated from the assets of the shareholder); and
  - shareholder action putting the company at risk (where a shareholder takes action resulting in insolvency (e.g., acceleration of loans resulting in illiquidity or termination of a necessary patent);

b liability based on a breach of provisions protecting the proper pay-in of share capital (including liability for unpaid capital contributions, liability for unpermitted returns of capital and breach of financial assistance rules); and

c liability up to the amount secured where a shareholder has granted a guarantee or security interest securing a loan of a portfolio company in financial crisis (as defined in the Company Reorganisation Act), in which case the portfolio company can request the shareholder to pay to the creditor the amount secured for so long as it is in financial

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crisis (in such case, the recourse claim of the shareholder is suspended until the financial crisis is over). If the portfolio company pays the creditor, the portfolio company can request reimbursement from the shareholder.

III YEAR IN REVIEW

i Recent deal activity

See Section I.i, *supra*.

ii Financing

The financing environment for buyout transactions more or less remained unchanged, and is quite different for domestic market participants, who typically seek financing from domestic banks, and international financial sponsors, who are able to tap international banks (at least on large-cap deals). Leverage levels for large-cap transactions have slightly gone up in 2017 to around 6x EBITDA, and relative debt-to-equity ratios of 50 per cent. Small to mid-cap transactions are sometimes financed through equity only or by domestic banks. Leverage levels and relative debt-to-equity ratios generally tend to be lower for small to mid-cap transactions than for large-cap deals.

Where leverage is employed on small and mid-cap transactions, there is usually only senior and institutional debt, as adding junior debt tends to add another layer of complexity that is often not supported by the limited transaction size. On large-cap transactions, separate junior debt is often added to the mix. Unitranche facilities are gaining ground (the most recent example being the Schweighofer Fiber transaction) High yield on the other hand, is of little significance in practice as the time and cost involved tends to be disproportionate to the gains on the pricing side. High yield does, however, play a role in post-completion refinancing.

iii Key terms of recent control transactions

See Section I.i, *supra*.

iv Exits

See Section I.i, *supra*.

IV REGULATORY DEVELOPMENTS

Domestic funds typically qualify as alternative investment funds (AIFs); as such, managers require a licence issued by the Austrian Financial Market Authority (FMA) under the Austrian Alternative Investment Manager Act (AIFMG). Most domestic funds qualify for the *de minimis* exception for managers of small AIFs with assets of less than €100 million (where leverage is used) or less than €500 million (where no leverage is used), and as such do not require a licence but are only required to register with the FMA. Another benefit is that they are only subject to a very limited number of regulations under the AIFMG.

Licensed AIFMs do not require any additional licences or permits for their investment activities. Registered AIFMs may require a trade permit for asset managers.

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i Licensing processes

Licensed AIFMs

To obtain a licence under the AIFMG, managers need to fulfil certain requirements:

a a licensed AIFM must have a minimum capital of €125,000 if it is an external manager of an AIF. If the AIFM is an internal manager of an AIF, the minimum capital requirement is €300,000. In addition, the AIFM must have sufficient equity to cover 25 per cent of its annual running costs. Increased equity requirements apply if the assets under management exceed €250 million; in any case, the maximum minimum capital requirement is €10 million. The persons tasked with the management of the AIFM must be sufficiently experienced, and must pass an FMA 'fit and proper' test if requested to do so;

b the AIFM must appoint at least two individuals as its managers; and

c in the application to the FMA, the AIFM must provide information on:
- shareholders holding qualified participations in the AIFM (i.e., shareholdings exceeding 10 per cent);
- any closely related entities (i.e., a third party that holds a stake of more than 20 per cent of the AIFM or that controls the AIFM, or is controlled by the AIFM or in which the AIFM holds a stake of more than 20 per cent);
- its business plan;
- its remuneration; risk management, valuation, internal audit and conflict-of-interest policies;
- its investment strategies;
- a description of any competences delegated to third parties; and
- information on the contractual basis pursuant to which it manages its AIFs.

A decision of the FMA regarding the licence must be passed within three months after the applicant has provided all required information. If the AIFM intends to register an AIF as an European long term investment fund, it has to apply to the FMA for prior approval.

Small AIFMs

As mentioned above, registered AIFMs may require a trade licence. A trade licence for asset managers requires an application to the competent trade authority. In such an application, the AIFM has to prove that he or she employs a person in a management function that has the necessary qualifications to supervise the business operations of an asset manager (typically, a university education or practical experience, or both).

ii Ongoing obligations

Licensed AIFMs are subject to the disclosure requirements under the AIFMG, which require, *inter alia*, the submission of an annual report to the investors and the FMA, as well as the submission of a quarterly overview of all AIFs under management.

Under the terms of the trade licence, there are no material ongoing reporting obligations for small AIFMs (except that they have to report if a person in a management function mentioned in the application leaves the AIFM).

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V OUTLOOK

2018 will see a couple of large-scale auctions involving assets that should attract PE interest. In the mid-market sector, technology as well as industrial products and services are expected to be hot sectors again. The real estate sector is also forecast to remain strong, while not on a par with 2017, which was a very busy year. Deal activity in the growth capital segment should also increase as there is a considerable pipeline of fast-growing (mostly tech) companies that will need series A or B financing soon. There will probably be increased hedge fund activity in 2018, which will mainly be related to the Steinhoff situation.

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Appendix 1

ABOUT THE AUTHORS

FLORIAN CVAK

Schindler Attorneys

Florian Cvak is a founding partner of Schindler Attorneys. Before establishing the firm, he was a partner at Schoenherr, where he co-headed the private equity practice. His track record includes some of the largest and most prestigious Austrian transactions, including the acquisition by a consortium of France Telecom and Mid Europa of Orange Austria and the subsequent sale to Hutchison and Telekom Austria. Private equity and hedge fund clients include funds like Goldman Sachs, Carlyle, Mid Europa, EQT, Riverside, Mezzanine Management, Darby, DBAG, Lion Capital, Fir Tree or LPC Capital.

Mr Cvak's practice focuses on corporate and corporate finance transactions in Austria and the CEE, with a particular focus on the areas of mergers and acquisitions, private equity, venture capital and LBO financings. Furthermore, he specialises in US lease and project finance transactions involving various types of utility assets. His practice is complemented by restructuring, general corporate and contracts work.

CLEMENS PHILIPP SCHINDLER

Schindler Attorneys

Clemens Philipp Schindler is a founding partner of Schindler Attorneys. Before establishing the firm, he spent six years as a partner at Wolf Theiss after practising with Haarmann Hemmelrath in Munich and Vienna, as well as with Wachtell Lipton Rosen & Katz in New York. His track record includes some of the largest and most prestigious Austrian and Austria-related transactions, such as the initial investment of América Móvil into Telekom Austria or Infineon's sale of its wireless business to Intel, as well as many private equity deals for international funds such as ARES, ARDIAN, Apax, DBAG, EQT, HIG, Internos, Kennet, Melrose, MDP, OpCapita, Riverside, Sankaty, Triton and TVM Capital.

Mr Schindler's practice focuses on corporate and tax law advice in relation to public and private M&A, private equity and corporate reorganisations (including mergers, spin-offs and migrations), most of which have a cross-border element. Furthermore, Clemens is specialised in international holding structures. His practice is complemented by private client work (e.g., as counsel to families owning stakes in large companies).

Mr Schindler is ranked by leading international legal directories including *Chambers Global*, *Chambers Europe*, *The Legal 500*, *IFLR1000* and *Who's Who Legal*. The German legal directory JUVE singles him out as one of Austria's top-20 corporate and M&A lawyers, while the Austrian business journal *Trend* named him among the country's top-10 corporate law

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experts. Besides the listings for the Austrian market, both *Chambers Global* and *Chambers Europe* acknowledge his Brazilian expertise in a special ranking.

Mr Schindler is admitted in Austria both as an attorney-at-law and a certified public tax adviser, holding law degrees from the University of Vienna and New York University (LLM in international taxation) as well as a degree in business administration from the Vienna University of Economics and Business Administration. He has authored and co-authored more than 50 articles, books and commentaries in his fields of expertise where he is also a much sought-after speaker at conferences and seminars.

SCHINDLER ATTORNEYS

Tuchlauben 13
1010 Vienna
Austria
Tel: +43 1 512 2613
Fax: +43 1 512 2613 888
martin.abram@schindlerattorneys.com
clemens.schindler@schindlerattorneys.com
florian.cvak@schindlerattorneys.com
www.schindlerattorneys.com

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THE PRIVATE EQUITY REVIEW

SEVENTH EDITION

Editor
Stephen L Ritchie

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TRILEGAL

URÍA MENÉNDEZ

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PREFACE

The seventh edition of *The Private Equity Review* follows a turbulent and at times nerve-wracking 2017. It was also a year in which private equity demonstrated its strength as an asset class in spite – perhaps because – of that turbulence. Deal activity and fundraising were strong in almost every major market despite fierce competition from public strategic buyers and strong returns in other asset classes, demonstrating private equity's ability to adapt quickly to changing conditions to find profitable investment opportunities. As a result, we expect private equity will continue to play an important role in global financial markets, not only in North America and Western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. In addition, we expect the trend of incumbent private equity firms and new players expanding into new and less-established geographical markets to continue, although recent protectionist trends remain a risk factor.

While no one can predict how 2018 will unfold, one can confidently say that private equity will continue to play an important role in the global economy, and will likely seek to expand its reach and influence. It remains to be seen how local markets and policymakers respond.

Private equity professionals need – now more than ever – guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 27 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this seventh edition of *The Private Equity Review* possible. Each of them is a leader in his or her respective market, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
March 2018

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Part I

FUNDRAISING

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Chapter 2

AUSTRIA

Martin Abram and Clemens Philipp Schindler[1]

I GENERAL OVERVIEW

At the time of writing, no information was available about the fundraising market in 2017 or 2016. The most recent information available is for 2015, for which the Austrian Venture Capital Association reported that Austrian private equity and venture capital funds raised €111 million, a significant increase over the fundraising in 2014 (below €20 million) and 2013 (around €20 million). However, most of this fundraising activity was related to one single fund focusing on early-stage investments.

The number and volume of Austrian private equity and venture capital funds continues to be well below the European average. Except for the one early-stage fund, there is no noticeable activity in the market.

Following general elections, a new Austrian government took office in December 2017. The government programme includes plans to implement an overall strategy for private equity as well as the creation of a competitive legal framework for venture capital and private equity funds. However, no specific implementation measures have been announced as of the date of this article.

II LEGAL FRAMEWORK FOR FUNDRAISING

Since the introduction of the AIFMG, which implements the AIFM Directive,[2] most private equity funds established in Austria will qualify as alternative investment funds (AIFs) under the AIFMG. An AIF is defined as a collective investment undertaking that raises capital from a number of investors to invest it in accordance with a defined investment policy for the benefit of those investors, and that does not use the capital for direct operational purposes. Funds pursuant to the Austrian Investment Funds Act as well as funds qualifying under the Austrian Real Estate Investment Funds Act are not captured by the AIFMG.

The formation of an AIF requires the prior approval of the Austrian Financial Market Authority (FMA) if the fund is managed by a licensed alternative investment fund manager (AIFM). If the fund is managed by a registered AIFM, it only needs to be registered with the FMA. AIFMs need to obtain a licence if they manage funds with assets of more than €100 million (where leverage is used) or more than €500 million (where no leverage is used); otherwise, only a registration is required.

1 Martin Abram and Clemens Philipp Schindler are partners at Schindler Attorneys.

2 Directive 2011/61/EU on alternative investment fund managers.

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In order to obtain a licence under the AIFMG, the manager must fulfil the following requirements:

a a licensed AIFM needs to have a minimum capital of €125,000 if it is an external manager of an AIF. If the AIFM is an internal manager of an AIF, the minimum capital requirement is €300,000. In addition, the AIFM needs to have sufficient equity to cover 25 per cent of its annual running costs. Increased equity requirements apply if the assets under management exceed €250 million; in any case, the maximum minimum capital is €10 million. The persons tasked with the management of the AIFM need to be sufficiently experienced, and have to pass a 'fit and proper' test of the FMA if so requested;

b the AIFM has to appoint at least two individual persons as its managers; and

c in the application to the FMA, the AIFM needs to provide information on shareholders holding qualified participations in the AIFM (i.e., shareholdings exceeding 10 per cent), on any closely related entities (i.e., a third party that holds a stake of more than 20 per cent of the AIFM or that controls the AIFM, or is controlled by the AIFM or in which the AIFM holds a stake of more than 20 per cent), its business plan, its remuneration, risk management, valuation, internal audit and conflict of interest policies, its investment strategies, a description of any competences delegated to third parties and information on the contractual basis pursuant to which it manages its AIFs.

The decision of the FMA regarding the licensing of an AIFM has to be made within three months after the applicant has provided all required information. If the AIFM intends to register an AIF as an ELTIF (see below), he or she has to apply to the FMA for prior approval.

i Vehicles used for private equity funds

The main vehicles used for private equity funds established in Austria are limited partnerships (LPs), typically with a corporation as the general partner, or corporations, namely limited liability companies (LLCs) and joint-stock companies (JSCs). Each of these types of entity has a separate legal personality, but partnerships are transparent for tax purposes.

LPs

Typically, investors become limited partners in an LP. The general partner is usually an LLC that receives a fee for assuming unlimited liability. In some structures, the general partner manages the partnership; in other structures, a separate management company (usually an LLC) manages the partnership. As private equity funds in most cases fall under the AIFMG, the entity managing the fund must be a legal person licensed or registered as an AIFM under the AIFMG. There are generally no minimum capital requirements for newly incorporated LPs.

Corporations

Investors become shareholders in an LLC or a JSC. An LLC is managed by a managing director, a JSC by a managing board. JSCs (as opposed to LLCs) are required by law to also have a supervisory board. Managing directors, as well as members of the managing board, have to be natural persons. However, as with LPs, corporations can outsource management functions to a management company, which in most cases needs to be licensed or registered as an AIFM under the AIFMG. Austrian law has minimum share capital requirements for LLCs (€35,000, or €10,000 in the case of a privileged incorporation) and JSCs (€70,000).

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In the past, sponsors also structured vehicles in the form of LLCs or JSCs as a medium-sized business financing company (MFG) under the Corporate Income Tax Act (KStG), as this gave rise to several tax benefits. MFGs had to fulfil certain requirements, such as higher capitalisation, participation of public bodies and certain investment restrictions. As those tax benefits no longer apply for vehicles founded after 2012, and will cease to apply in respect of participations held by existing MFGs (founded before 2012) by the end of 2015 (in special circumstances, by the end of 2018), the importance of the MFG has decreased significantly. The tax benefits for MFGs have been reintroduced in 2017, however, only to a limited extent. In particular, the tax benefits only apply for minority investments in early-stage enterprises.

ii Key legal terms

In addition to terms imposed by mandatory provisions of Austrian law, in particular the investor protection provisions of the AIFMG for private equity funds classified as AIFs, the key terms of the relationship between the investor and the fund are governed by the partnership agreement (for LPs) or the articles of association and shareholders' agreements (for LLCs and JSCs). Terms of a private equity fund typically subject to negotiation include:

- *a* investment restrictions, such as target size, concentration limits, geographic limitations, diversification of industries, limits on borrowing and related-party transaction restrictions;
- *b* limitations on the fund's size and the investors' capital commitments;
- *c* investment period;
- *d* key-man provisions;
- *e* provisions permitting the removal of the manager by a qualified majority of investors;
- *f* remuneration of the manager (i.e., management fee, investment-related fees and carried interest);
- *g* reinvestments; and
- *h* exclusivity.

iii Disclosure of information

In recent years, Austria has seen an increasing number of court proceedings by private investors against managers and promoters of funds to recover losses suffered during the financial crises. These proceedings highlight the importance of full disclosure to investors at the time they invest in a fund.

Managers of funds need to ensure that all documents given to investors, in particular the offering documentation and all advertising material, disclose all facts and circumstances relevant to prospective investors fully and correctly. Additionally, special care should be taken that any opinions and plans disclosed to investors are reasonable, and based on verifiable facts. Special care also needs to be taken to ensure that the wording of the documents is not too complicated or technical; otherwise there is a risk that this could be seen as insufficient disclosure. Austrian courts do, by and large, take into account the types of investors to which such offering documentation is addressed, and may take a less restrictive position in cases where an offer is solely addressed to institutional investors (as opposed to offers addressed to retail investors).

In the case of insufficient disclosure, managers are faced primarily with damage claims, rescission claims, or a combination of both by investors; additionally, regulatory sanctions and – in extreme cases – criminal sanctions may apply.

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The key items for disclosure vary depending on whether the offer of the fund interest falls under the scope of the Austrian Capital Markets Act (in which case a prospectus conforming to the EU prospectus regime has to be published). Typically, the main items for disclosure are:

a investment strategy;
b market overview and regulatory environment;
c key terms of the investment (see above);
d risk factors;
e track record of the manager and its executives; and
f tax matters.

If the offer of interests in a private equity fund falls under the scope of the Austrian Capital Markets Act (and no private placement exemption applies), the issuer has to prepare a prospectus, which complies with the EU prospectus regime, except for (1) offers encompassing fund interests with a total value of less than €5 million during a 12-month period, in which case a simplified prospectus can be used, and (2) offers encompassing fund interests of LPs, in which case the prospectus regime of the Austrian Capital Market Act has to be used. In this case, additional disclosure requirements apply.

iv Solicitation

The method of solicitation is mainly influenced by regulatory constraints. Most commonly, solicitation is made by way of an information or offering memorandum. Potential key investors are typically contacted at an early stage to gauge their initial interest. Unless there are regulatory constraints (such as in the case of public offers falling under the scope of the Austrian Capital Markets Act), investors are invited to follow-up meetings or given the opportunity for a limited due diligence. Depending on the size of the fundraising, managers may also appoint third-party promoters to assist in identifying potential investors; also in addition, outside counsel is retained to prepare the documentation for the fundraising.

Limitations on solicitation

Offers and sales of interests in private equity funds formed in Austria are subject to the following selling restrictions, which depend on the category of the private equity fund.

For AIFs managed by a licensed AIFM:

a interests in the fund may only be offered or sold after the AIF is approved by the FMA; and
b interests in the fund may be offered or sold to private investors, if the prerequisites of Sections 48 and 49 AIFMG are met, except if the fund is registered (1) as a European venture capital fund (EuVECA) (see below); in this case, it may be offered to private investors subject to certain restrictions (in particular, a minimum investment commitment of €100,000 and a written acknowledgment of the risks associated with the investment by the private investor) or (2) as a European long-term investment fund (ELTIF) (see below); in this case, it may be offered to private investors subject to certain restrictions (in particular, an offer is only possible to private investors having an investment portfolio of at least €100,000 after such investor has received appropriate investment advice).

For AIFs managed by a registered AIFM:

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a interests in the fund may only be offered after the AIF was notified to the FMA; and
b interests in the fund may not be offered or sold to private investors, except if the fund is registered as an EuVECA (see below); in this case, it may be offered to private investors subject to certain restrictions (in particular, a minimum investment commitment of €100,000 and a written acknowledgment of the risks associated with the investment by the private investor). No ELTIF registration is available for funds managed by registered AIFMs.

For private equity funds falling outside the AIFMG:
a any public offer of interests in private equity funds falling outside the AIFMG requires the publication or approval of a prospectus by the FMA, or both, unless a private placement exemption applies;
b the private placement exemption applies, in particular, for offers to qualified investors only, offers with a minimum investment amount of €100,000, and offers to less than 150 investors; and
c even if the private placement exemption applies, the intended offer has to be notified to the issue register maintained by Oesterreichische Kontrollbank AG.

v EuVECA Regulation[3]

The EuVECA Regulation was introduced to create a new pan-European designation for small AIFMs, the EuVECA. Austrian-based AIFMs may register an AIF as a EuVECA provided that they comply with the EuVECA Regulation and have supplied certain information with regard to themselves and the relevant AIF to the FMA. The main advantage the AIFM gains by doing so is the option to market the relevant AIF throughout the EU under the EuVECA designation to certain categories of investors defined in the EuVECA Regulation under an EU-wide passporting regime. Passporting allows a firm authorised under an EU single market directive to market the designated fund to certain qualified investors in another EU Member State, on the basis of its home state authorisation.

The EuVECA Regulation is not compulsory; if an AIFM does not want to use the EuVECA designation, then it does not have to comply with the EuVECA Regulation for a particular fund (or at all). If the AIFM chooses not to use the EuVECA designation, national laws and EU regulations apply, such as national private placement regimes.

vi ELTIF Regulation[4]

The ELTIF Regulation was introduced in November 2015 to channel capital raised through AIFs towards European long-term investments in the real economy. Austrian-based AIFM who have received approval to manage ELTIFs may register an EU-based AIF (or a compartment thereof) as an ELTIF provided that they comply with the authorisation requirements set forth in the ELTIF Regulation and submit an application to the FMA. The main advantage of such registration is the option to market the relevant AIF throughout the EU under an EU-wide passporting regime similar to the regime under the EuVECA Regulation (see above). Additionally, the designation of an AIF as an ELTIF allows its marketing to high net worth individuals throughout the EU.

3 Regulation (EU) 345/2013 on European venture capital funds.
4 Regulation (EU) 760/2015 on European long-term investment funds.

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The ELTIF Regulation is not compulsory; if an AIFM does not want to use the ELTIF designation, then it does not have to comply with the ELTIF Regulation for a particular fund (or at all). If the AIFM chooses not to use the ELTIF designation, national laws and EU regulations apply, such as national private placement regimes.

vii Fiduciary duties to the investors

Typically, the scope of the sponsor's fiduciary duties is determined by the AIFMG (which most private equity funds fall under), the constitutional documents of the fund vehicle (supplemented by pertinent rules of law) and other contractual arrangements (if any).

Under the AIFMG, the manager has, *inter alia*, to act in the best interests of the investors in such AIF (as well as of the AIF itself) and the integrity of the market. The manager has to introduce appropriate procedures to deal with conflicts of interest, to treat the investors in an AIF fairly, and to use the required diligence in the performance of his or her duties.

Managers of Austrian private equity funds are most frequently general partners of an LP or fulfil their function based on management agreements with the fund vehicle. Thus, the scope of the managers' duties and the extent of their liability in relation to the investors (and the fund vehicle) derive from the partnership agreement (supplemented by the mandatory provisions of the Commercial Code) or, as the case may be, the management agreement.

Unless the private equity fund is an AIF, it is possible to limit the liability of the sponsor in relation to the investors or, respectively, the fund vehicle by contractual provisions (e.g., excluding the liability for 'ordinary negligence'). However, such contractual provision would still be subject to judicial review.

III REGULATORY DEVELOPMENTS

Private equity funds established as AIFs and their managers are subject to the ongoing supervision of the FMA. The FMA has a wide range of inspection and audit rights with respect to both the AIFM and the respective AIF.

Austrian law distinguishes between AIFMs, which require licensing by the FMA, and AIFMs, which only have to register with the FMA. Licensed AIFMs do not need any additional licences for their management activities for the fund. Registered AIFMs may require a business permit for asset managers.

As mentioned above, investors holding qualified participations in the AIFM (i.e., shareholdings exceeding 10 per cent) need to be disclosed to the FMA, but only by licensed AIFMs.

Private equity funds established as AIFs need to be registered with the FMA. Private equity funds established as AIFs and managed by a licensed AIFM also require approval by the FMA. Austrian AIFs are also listed in an informal register maintained by the FMA.

Private equity funds not established as AIFs require no special registration, except for the registration with the Companies Register upon incorporation.

If the sponsor also acts as the manager of a fund established as an AIF, it has to be registered or, as the case may be, licensed with the FMA. In addition, if the sponsor holds a qualified participation in the fund, this fact has to be disclosed to the FMA.

Otherwise, no specific licence requirements exist for the sponsors of a fund.

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i Taxation

Taxation of the fund

As mentioned above, the most common private equity fund vehicle in Austria is a partnership. Different from corporations, Austrian partnerships are typically viewed as transparent for tax purposes, provided that the partnership's sole activity qualifies as asset management for tax purposes, and it is not deemed to operate a business or commercial operation.

Any income derived by the partnership is allocated to its investors and taxed at their level in accordance with the rules of the tax regime applicable to the respective investor.

For partnerships structured with no individual (but only a corporation) as general partner, as is usually the case, equity contributions had generally been subject to capital duty at a rate of 1 per cent. The same was true for fund vehicles structured as corporations. Capital duty, however, is not levied anymore since 1 January 2016. Another area to consider is stamp duties, in particular in relation to guarantees that the formation documentation may entail. In this context, it should be noted that surety agreements (including any form of assumption of a debt as joint debtor) are subject to stamp duty at a rate of 1 per cent of the secured amount provided that the surety is of an accessory nature, which means that the guarantor may avail itself not only of all defences that it personally has against the creditor, but also of all defences that the debtors of the secured debt have against the creditors. If the guarantee, however, is of an abstract nature, meaning that the guarantor has to pay upon first demand and has recourse only to those defences that arise from the guarantee itself, then such transaction is not subject to stamp duty. Therefore, guarantee wordings explicitly stating that a specific guarantee is intended as an abstract are commonly used.

Taxation of investors

Domestic individual investors are taxed as follows: capital gains are subject to a preferred tax rate of 27.5 per cent (as of 1 January 2016); and dividends are subject to withholding tax at a rate of 27.5 per cent (as of 1 January 2016).

Domestic corporate investors are taxed as follows: capital gains are taxed at a rate of 25 per cent if they relate to an Austrian-resident portfolio company, and may be tax-exempt if they relate to a foreign-resident portfolio company in which a minimum shareholding of 10 per cent is (indirectly) held for an uninterrupted period of at least one year (Section 10, KStG); and dividends are tax-exempt if they relate to an Austrian-resident portfolio company or an EU-resident portfolio company, and may be tax-exempt under certain conditions if they relate to another foreign portfolio company (Section 10, KStG).

Foreign individual investors are taxed as follows: capital gains are only taxable (at a rate of 27.5 per cent as of 1 January 2016) if the percentage of the investor's (weighted) shareholding in the Austrian portfolio company (through the partnership) is at least 1 per cent during the past five years. Note that double tax treaties usually restrict Austria's right to tax such capital gains (Article 13, Paragraph 5 of the OECD Model Tax Convention on Income and on Capital (MTC)); and dividends are subject to withholding tax at a rate of 27.5 per cent (as of 1 January 2016) (subject to a reduction under applicable double tax treaties).

Foreign corporate investors are taxed as follows: capital gains are only taxable (at a rate of 25 per cent) if the percentage of the investor's (weighted) shareholding in the Austrian portfolio company (through the partnership) is at least 1 per cent during the past five years. Double tax treaties usually restrict Austria's right to tax such capital gains (Article 13, Paragraph 5, MTC); and dividends are subject to withholding tax at a rate of 25 per cent

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in cases where the exemption for foreign investors that are corporations resident in an EU Member State is not applicable (but will usually be subject to a reduction under applicable double tax treaties).

Taxation of carried interest

'Carried interest', which is defined as the compensation of a partner of an asset management partnership received because of outstanding contributions to the successful management of the investments, is included in the investment income according to the Department of International Taxation of the Ministry of Finance.[5] Income qualifying as investment income received by an individual who is subject to unlimited taxation in Austria is taxable in Austria with the special tax rate of 27.5 per cent (as of 1 January 2016). Despite this administrative guideline, a case-by-case analysis is recommended, as the line between self-employed and employee income and investment income is rather unclear.

The management fees received by a partner of an asset management partnership are not subject to VAT. According to the Austrian tax authorities, the managing partner of a partnership is not an entrepreneur; his or her services are supplied in the exercise of a corporate function, and not as a result of an exchange of services. If the fund vehicle is a corporation, however, the fees of a managing partner will usually be subject to VAT, unless the manager is employed by the corporation.

IV OUTLOOK

In 2015, fundraising by Austrian-based private equity amounted to €111 million, a significant increase over the fundraising in 2014 (below €20 million) and 2013 (around €20 million). However, most of this fundraising activity was related to one single fund focusing on early-stage investments. No specific figures for 2016 or 2017 have been released yet, but it is expected that fundraising will remain at a very low level compared to other European countries.

Following general elections, a new Austrian government took office in December 2017. The government programme includes plans to implement an overall strategy for private equity as well as the creation of a competitive legal framework for venture capital and private equity funds. However, no specific implementation measures have been announced as of the date of this article. It remains to be seen whether (and if so, when) the current government will actually start implementing the announced programme and whether such implementation will have a positive impact on fundraising activities in the future.

5 EAS 3280 as of 14 May 2012, EAS 2698 as of 6 February 2006 and BMF 15 December 2008 (BMF 010221/3364-IV/4/2008).

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Appendix 1

ABOUT THE AUTHORS

MARTIN ABRAM

Schindler Attorneys

Martin Abram is a founding partner of Schindler Attorneys. Before establishing the firm, he spent 15 years at Wolf Theiss, where he became a partner in 2002.

Mr Abram's practice focuses on corporate, real estate and financing work, with a particular focus on corporate and real estate mergers and acquisitions, corporate reorganisations and project and real estate financing. Furthermore, he is also active in equity capital market transactions and commercial and residential leasing transactions. His practice is complemented by general real estate work and contracts work.

Mr Abram holds law degrees from the University of Vienna and the University of Nottingham law school. He is admitted to the Austrian Bar.

Mr Abram has published articles regarding corporate and energy law, has contributed to several Wolf Theiss publications, and is an author and co-editor of a book on the general meeting of Austrian stock corporations.

CLEMENS PHILIPP SCHINDLER

Schindler Attorneys

Clemens Philipp Schindler is a founding partner of Schindler Attorneys. Before establishing the firm, he spent six years as a partner at Wolf Theiss after practising with Haarmann Hemmelrath in Munich and Vienna, as well as with Wachtell Lipton Rosen & Katz in New York. His track record includes some of the largest and most prestigious Austrian and Austria-related transactions, such as the initial investment of América Móvil into Telekom Austria or Infineon's sale of its wireless business to Intel, as well as many private equity deals for international funds such as ARES, ARDIAN, Apax, DBAG, EQT, HIG, Internos, Kennet, Melrose, MDP, OpCapita, Riverside, Sankaty, Triton and TVM Capital.

Mr Schindler's practice focuses on corporate and tax law advice in relation to public and private M&A, private equity and corporate reorganisations (including mergers, spin-offs and migrations), most of which have a cross-border element. Furthermore, Clemens is specialised in international holding structures. His practice is complemented by private client work (e.g., as counsel to families owning stakes in large companies).

Mr Schindler is ranked by leading international legal directories including *Chambers Global*, *Chambers Europe*, *The Legal 500*, *IFLR1000* and *Who's Who Legal*. The German legal directory JUVE singles him out as one of Austria's top-20 corporate and M&A lawyers, while the Austrian business journal *Trend* named him among the country's top-10 corporate law

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experts. Besides the listings for the Austrian market, both *Chambers Global* and *Chambers Europe* acknowledge his Brazilian expertise in a special ranking.

Mr Schindler is admitted in Austria both as an attorney-at-law and a certified public tax adviser, holding law degrees from the University of Vienna and New York University (LLM in international taxation) as well as a degree in business administration from the Vienna University of Economics and Business Administration. He has authored and co-authored more than 50 articles, books and commentaries in his fields of expertise where he is also a much sought-after speaker at conferences and seminars.

SCHINDLER ATTORNEYS

Tuchlauben 13
1010 Vienna
Austria
Tel: +43 1 512 2613
Fax: +43 1 512 2613 888
martin.abram@schindlerattorneys.com
clemens.schindler@schindlerattorneys.com
florian.cvak@schindlerattorneys.com
www.schindlerattorneys.com

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